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August 19, 2016

Ms. Monica Jackson
Office of the Executive Secretary
Consumer Financial Protection Bureau
1700 G Street NW
Washington, D.C. 20552

RE: Proposed Rule and Request for Comment on Arbitration Agreements (RIN 3170-AA51)

Dear Ms. Jackson:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only national trade association focusing exclusively on federal issues affecting the nation's federally-insured credit unions, I am writing in regards to the Consumer Financial Protection Bureau's (CFPB) proposed rule to prevent providers of certain consumer financial products from prohibiting class action lawsuits in their arbitration agreements. NAFCU supports consumer rights and the CFPB's efforts to protect consumers, but also has several serious concerns about the arbitration rule, including: (1) the ultimate conclusions derived from the CFPB's final arbitration study used in the proposal; (2) the potential unintended consequences this proposed rule may have on credit unions and their members; and (3) the costs to providers and consumers. NAFCU strongly recommends that credit unions be exempt from any arbitration rulemaking.

General Comments

In the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act), Congress directed the CFPB to study pre-dispute arbitration agreements for consumer financial products and services. The Dodd-Frank Act also authorized the CFPB to, after the completion of its study, issue regulations restricting or prohibiting the use of arbitration agreements if the study revealed that such rules would be in the public interest and for the protection of consumers. In December 2013, the CFPB published the preliminary results of its study on arbitration, and then in March 2015, the CFPB released its final arbitration study: *Arbitration Study: Report to Congress 2015* (the Study). In accordance with the Study, the CFPB unveiled its proposed rule on May 24, 2016, which restricts pre-dispute arbitration clauses from blocking consumer class actions, requires providers to alter their contracts to reflect this rule, and establishes certain monitoring requirements for arbitration claims and awards.

On October 10, 2015, the CFPB convened a Small Business Regulatory Enforcement Fairness Act (SBREFA) Panel consisting of eighteen small business representatives to review the proposal and provide comments and suggestions. The SBREFA Panel concluded that the proposed rule would not be in the public interest because of increased costs to consumers, reduced incentive for innovation in the financial industry, windfalls to named plaintiffs and class members, and negative effects on informal dispute resolution mechanisms. Moreover, the SBREFA Panel shared their concerns and suggested the CFPB continue to study and seek more information on the following issues: (1) the costs of defending a class action lawsuit and the risk of it putting a small entity out of business; (2) the ability to obtain insurance coverage for class action litigation defense costs; (3) the impact of class actions on small entities' conduct, particularly whether the potential for class action would increase compliance with consumer finance laws; (4) higher litigation costs leading to increased costs of business credits; and (5) no limits for damages in class action litigation based on certain statutory causes of action, such as the Telephone Consumer Protection Act.

NAFCU echoes the concerns of the SBREFA Panel and believes that the CFPB should devote more time and resources to exploring these issues before promulgating a final rule. NAFCU continues to believe that voluntary arbitration agreements provide a useful means of dispute resolution for many credit unions and their members. Although the CFPB's proposed rule does not ban arbitration agreements entirely, the proposal to eliminate mandatory arbitration, more specifically "class action waivers," is a step in that direction. Most concerning are the proposed monitoring requirements for certain records relating to arbitral proceedings and the subsequent publication of those materials on the CFPB's website.

Not only does this proposal have the potential to impose an additional regulatory burden on credit unions with limited resources, but it also presents a reputational risk for credit unions that is not necessarily justified by the purported benefit to consumers. Therefore, NAFCU urges the CFPB to consider alternative methods of providing consumer relief in the dispute resolution process. Consumer education, required disclosures, and a required "opt-out" system are all excellent alternatives. Credit unions should be excluded from the final arbitration rule because they are not responsible for even a small fraction of the deceit and destructive behavior in the financial industry that the CFPB cites as motivation for this rule. At a minimum, credit unions should be exempt from the monitoring requirement of the proposed rule, so as to lessen the compliance burden on small entities that solely aim to help, and not hurt, their consumers.

The CFPB's Study

Since its inception, the CFPB has taken a data-driven approach to its rulemaking and states it is doing so here. Yet, NAFCU is concerned that the CFPB's Study is flawed and does not support conclusions reached in the proposed rule. NAFCU believes the Study is incomplete and presents a skewed picture of class action lawsuits compared to arbitration. In addition, it does not appear that that the Bureau engaged in a proper cost-benefit analysis.

The most troubling aspect of the Study is that it does not analyze data for arbitration settlements because that data was unavailable, but then compares arbitration awards with class action settlements. Such a comparison conflates two different types of data and exaggerates the benefits of class action while downplaying the advantages of arbitration. A publically available study, from the Mercatus Center, on the subject of arbitration and class action notes that the CFPB's Study indicated 23% of American Arbitration Association (AAA) consumer arbitrations were known to have settled and an additional 34% were likely to have settled. This suggests that the vast majority of consumer arbitrations the CFPB studied were likely or known to have settled. On the other hand, a drastically smaller percentage of the class action cases studied by the Bureau actually settled. Therefore, a proper comparison would have compared successful consumer arbitrations (resulting in awards) to the 2% of consumer class actions in which consumers received an individual or class-wide judgment. NAFCU believes that the CFPB should conduct further studies to appropriately compare data on arbitration and class action cases.

Moreover, the CFPB's Study showed that individual cases as well as arbitrations were resolved quicker than class action cases. In addition, arbitration resulted in higher individual settlements than class action lawsuits. Thus, the CFPB's own study proves two of the main benefits of arbitration: it is cheaper and faster than a court proceeding. Nonetheless, the CFPB concludes that arbitration must be limited and class actions expanded to solve a two-fold market failure: a lack of consumer awareness that a wrong has been committed and that they have a legal claim, as well as the impracticality of pursuing a negative-value claim.

Class arbitration is an alternative that could potentially solve this perceived market failure and more because consumers would be made aware of their legal claim and have a cost-effective means of pursuing even a small dollar claim, as well as a chance of receiving a higher settlement than in a class action lawsuit. But class action arbitration is an option that the CFPB gives very little attention to because there is little to no data available. Perhaps more time spent evaluating class action arbitration as a means of solving this alleged market failure would lead the Bureau to formulate a final rule that does not eliminate "class action waivers," but instead requires providers to allow for class action arbitration.

Another concern is the small number of credit unions studied and the lack of additional studies on the effect that this rule may have on small entities, such as credit unions. Credit unions have limited resources to devote to litigation and arbitration provides a quick, confidential, and inexpensive means of resolving consumer disputes in a manner that benefits both parties. Expanding the channel of class action lawsuits may cause significant damage to credit unions. Consequently, NAFCU requests the CFPB conduct further studies on the effect this proposed rule may have on credit unions before issuing a final rule.

The Potential Effect on Credit Unions

If this rule is implemented as proposed, it could have a negative impact on credit unions. Although credit unions use arbitration clauses sparingly and use them responsibly when they do

so, several of our members have voiced their concerns that this rule will only increase the incidence of frivolous class action law suits they already face. For example, one of our members recently defended against a class action lawsuit that they believed to be completely unfounded; however, they still had to pay a significant sum of money to resolve the dispute. The credit union managed to settle the dispute with a modest settlement, but had to pay 18 times that amount in attorney's fees. Although the actual payout in that case was rather insignificant, the amount of attorney's fees was staggering. NAFCU and its members are concerned that such cases would become the norm as a result of the implementation of this proposed rule.

Increased Costs

The Bureau itself points out the fact that it cannot accurately estimate the expected cost on small providers as a result of the rule and that some will face considerably higher expenses per year because of the additional Federal class settlements. It is unlikely that such higher expenses will make a difference for banks or other multinational financial institutions that are accustomed to regularly facing class action lawsuits because of their unscrupulous behavior. But such expenses could meaningfully change the operations of a credit union and cause its members to pay higher fees and lose money in the form of dividends. In a recent survey conducted by NAFCU's Economic & CU Monitor, almost half of the respondents said they believe that the CFPB's proposal is likely to have an impact on the cost of credit that credit unions will be able to extend to their members. A negative impact on credit unions' ability to serve their members is a likely result of this arbitration rule.

Aside from potentially facing a higher cost of doing business and class action lawsuits that could markedly impact a credit union's resources, the most troubling part of the proposed rule is the monitoring requirements. The CFPB's proposal claims the requirement that providers submit specified information about arbitral records, including the claims, awards, and certain other materials filed in arbitration cases, will have a minimal impact in terms of added cost, even for small providers. For credit unions, however, time really is money, and every dollar spent on compliance with burdensome regulations is a dollar that cannot be passed on to members.

The CFPB is placing the burden of redaction on financial institutions, hence adding yet another expense for credit unions. Not only will credit unions have to devote time and money to rewriting their contracts, but they will also have to allocate resources to filtering through arbitration records and redacting members' personal information, then providing those records to the CFPB. The business model of credit unions is unique within the financial services industry and provides numerous benefits, but also makes it more difficult and expensive to comply with regulations that pose significant risks and have the potential to hamstring day-to-day operations and relations with members. The arbitration rule would be one such regulation and credit unions should, therefore, be excluded from the rule or, at the very least, this monitoring requirement.

Reputational and Privacy Risk

NAFCU and our member credit unions strongly support measures to better protect consumers' privacy interests and ensure that no sensitive material is released to the public, but simultaneously advocate for increased privacy protections for our members. According to the proposed rule, after collecting information about arbitration claims and awards, the CFPB plans to create an online database available to the public. The CFPB assures readers that relevant personal information will be redacted before publication on the CFPB's website, but such redactions will only cover consumers' personal information. Non-public information about a credit union and the people who work and volunteer for the credit union would not be subject to such redactions.

This flies in the face of one of the primary benefits of arbitration: confidentiality; and it also means that credit unions will be exposed to potentially severe reputational risks. There might even be a risk that some plaintiff's attorneys may take advantage of this information to bring unfounded actions against credit unions. Furthermore, public access to potentially sensitive information about a credit union and its operations has the potential to harm credit unions, their members, and the financial services industry at large. The benefits of releasing arbitration records to the public likely do not outweigh the risk to credit unions' privacy created by the release of such information.

Credit unions are not the bad actors trying to "cheat" consumers that the CFPB's proposed rule is meant to target. As not-for-profit entities, credit unions work to benefit their members instead of working against them. Thus, the logic that this rule and its monitoring requirement will ensure consumers are not being scammed and they are better informed does not apply to credit unions. Credit unions should have the ability to use arbitration clauses because even a single frivolous class action lawsuit could jeopardize the safety and soundness of a credit union. Consequently, NAFCU fiercely advocates for an exemption standard that acknowledges the unique structure of credit unions in the financial industry and recommends the CFPB exempt credit unions from its arbitration rulemaking.

The Proposed Rule's Likely Effect on Consumers

Most importantly, the proposed rule does not address the core issue underlying dispute resolution: lack of consumer awareness and understanding. To properly protect consumers, the CFPB should seek to enhance access to legal remedies. Although the proceeding is different than a traditional court proceeding, arbitration is still a legal proceeding. Therefore, consumers are not currently being deprived of access to the legal system. This rule, however, would restrict consumer access by essentially closing off an avenue of alternative dispute resolution that has been historically proven to benefit consumers. This arbitration rule would inflict harm on the court system, credit unions, and consumers.

"Opt-out" Clause as an Alternative

Instead of preventing arbitration from providing consumers with an efficient and cost-effective means of resolving their disputes, the CFPB should engage in educating consumers about their options. Additionally, the CFPB could require disclosures in the contracts financial institutions give to their consumers, which would explain the arbitration proceeding, and also require consumers to "opt-out" of arbitration. The Bureau's only counterargument to an "opt-out" system is that it would not solve the above-mentioned "market failure." But with an "opt-out," consumers would still have a choice to not participate in mandatory arbitration to resolve a dispute with their provider. It is also unclear that the proposed rule itself would solve this alleged market failure because consumers will still have very little incentive to participate in a class action lawsuit and have a chance at recovering a whopping average settlement of $32.35. It is highly unlikely that the proposed rule will solve the collective action problem.

The CFPB claims that this rule will allow consumers with small dollar claims to join larger actions and actually obtain relief. As explained above, consumers may do this through class action arbitration too and are probably likely to receive a larger settlement than a class action lawsuit. Although the Study indicates that there is very little data available regarding class action arbitration, the CFPB should focus its efforts on increasing consumer awareness of class action arbitration and the flexibility of the process to bolster its use. Likewise, an "opt-out" of arbitration clauses could meaningfully enhance consumer protection and provide consumers with more legal remedies to resolve their disputes.

The Benefits of Arbitration

The CFPB's Study actually indicates that consumers are not only unaware of the benefits of arbitration, but are also generally averse to dispute resolution, whether through litigation or otherwise. The Study did not prove that increased opportunity for class action lawsuits will necessary result in consumers flocking to the courts to redress their minor dispute with a provider. Chances are that consumers will still contact their providers and have dispute resolved internally, like the vast majority of disputes are already handled.

The only sure effects of the arbitration rule would be: (1) an unprecedented and staggering cost to providers, between $2.62 and $5.23 billion for 53,000 providers to defend against new class actions; and (2) increased costs to consumers as taxpayers because of new backlog in the court system and higher fees for litigation of the resultant class actions. Considering that most providers do not even use arbitration agreements, much less "class action waivers" in their agreements, it is puzzling that the CFPB has chosen to target arbitration as its latest proposed regulation of the financial industry. Ultimately, the biggest effect of this rule will be high costs for credit unions and other financial institutions and relatively little return for consumers.

Conclusion

NAFCU is troubled by the financial and compliance burden this arbitration rule will impose on credit unions. If the rule is adopted as proposed, credit unions will likely face increased costs, potentially frivolous class action lawsuits, extreme reputational risks, and privacy concerns. Accordingly, NAFCU and its members implore the CFPB to exempt credit unions from its final arbitration rule.

NAFCU appreciates the opportunity to provide our comments on the proposed rule prohibiting the use of "class action waivers" in arbitration agreements. If you have any questions or concerns, please do not hesitate to contact me at akossachev@nafcu.org or (703) 842-2212.

Sincerely,

Ann Kossachev
Regulatory Affairs Counsel